

OFFICE OF THE MISSISSIPPI SECRETARY OF STATE

POLICY STATEMENT ON VIATICAL SETTLEMENT CONTRACTS

The Business Services Division of the Mississippi Secretary of State's Office (the Division) has received numerous inquiries from investors, viatical settlement companies and participants in the securities industry generally regarding the treatment of viatical settlements under the Mississippi Securities Act (the "Act") Miss Code Ann. §§75-71-101, *et. seq.* (Rev.1991). The Securities Enforcement Unit is aware of instances in which viatical settlements have been advertised to the investing public as 100 per cent secure, with "guaranteed" rates of return as high as 40 per cent or more. Many persons making such claims have not registered the viatical settlement agreements for sale in Mississippi, and more often than not, the persons offering the same have not been registered under the Act as broker-dealers, agents, investment advisers or investment adviser representatives, as is required pursuant the Act.

The administration of the Mississippi Securities Act is vested in the Secretary of State of Mississippi. Miss. Code Ann. § 75-71-107 (Rev. 1991 & Supp. 1998). The Secretary of State is authorized to make such rules and orders as are necessary to carry out the provisions of the Act, including those governing registration statements, and may define any terms, whether or not they are used in the Act. Furthermore, for the purpose of rules and forms, the Secretary of State may classify securities and prescribe different requirements for different classes. Miss. Code Ann. § 75-71-109 (Rev. 1991 & Supp. 1998). Accordingly, and following a careful consideration of the applicable provisions of

the Act, the regulations promulgated thereunder, and relevant case authority, the Secretary has concluded that for the reasons set forth herein, viatical settlement investments should be treated as securities subject to the registration and other provisions of the Act.

A viatical settlement agreement generally is a written agreement entered into among a viatical company facilitating the transaction, an investor (or a group of investors) and a medically documented terminally ill person who is the owner of a life insurance policy or who is covered under a group policy insuring the life of such person. The premise behind the viatical settlement is to give those with a catastrophic or terminal illness monetary means with which to live and to pay medical expenses when the medical condition is at a stage where continued employment may not be possible. In the agreement described above, the insured agrees to sell the life insurance policy at a discount, the amount of which is based on the life expectancy of the insured, current interest rates and the profit requirement of the investors and the viatical company. The viatical company (or a trust established by the viatical company) is named as the irrevocable beneficiary and is obligated to continue making the necessary premium payments.

In the alternative, the viatical company may simply match potential buyers with the policyholders in an arrangement whereby the investor acquires direct ownership rights in the policy. Under either arrangement, the viatical company offers and sells fractional or whole interests in the policy to investors, thus eliminating the need for direct contact between the insured and the investor. Upon the death of the insured, the viatical company receives the face value of the policy, which is then used to repay investors a

profit equal to the difference between the discounted purchase price paid to the insured and the death benefit collected under the policy from the insurer, less certain administrative costs and expenses, including premiums and a commission to the viatical company.

The question of whether or not the foregoing arrangement is properly characterized as a security is answered by reference to long-standing principles governing the interpretation of the Act by both the Secretary of State and the courts. The statutory definition of a “security,” Miss. Code Ann. §75-71-105 (Rev.1991 & Supp. 1998), is in all material respects identical to that contained in most state acts and the Securities Act of 1933. This definition of a security includes the term “investment contract.” The Secretary of State considers the United States Supreme Court’s analysis in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) to be persuasive in defining the term “investment contract”. The *Howey* test holds that an investment contract has four principal elements or criteria: (i) the investment of money; (ii) in a common enterprise; (iii) with an expectation of profits; (iv) to be earned through the efforts of others. The fourth prong of the *Howey* test was clarified in *SEC v. Glenn W. Turner Enterprises*, which held that the “efforts” referred to “are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.” *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 (9th Cir.) *cert. denied*, 414 U.S. 821 (1973). The Secretary concurs in this reasoning. Applying these elements to the viatical arrangement, it is clear that it is an investment contract, and thus, a security.

In point of fact, the investors in typical viatical settlement arrangements are, as a rule, completely passive, relying upon the expertise of and information gathered by the

viatical company in predicting the insured's life expectancy, preparing the documentation for investment and performing all other functions essential to the investor's ability to achieve a profit. The investors do not have the skill, knowledge or access to information to perform the tasks that are necessary for their investment to be successful.

The actions which may be, and usually are, performed by the viatical company in connection with the settlement transaction include, but are not limited to: identification of insured parties with short life expectancies; evaluation of the medical condition of the insured; analysis of the life expectancy of the insured; determination of the discount at which to purchase the policy; evaluation of the terms and conditions of the policies; effectuation of the legal transfer of the policy from the insured; effectuation of changes in beneficiaries; determination of whether an insured party has died to ensure timely submission of claims for death benefits; submission of claims for death benefits to insurance companies; acceptance of payment of death benefits from insurance companies; pooling of the policies for investors; computation and distribution of pro rata shares of benefits to investors; and other actions in the process of selecting, evaluating, acquiring and packaging insurance policy benefits to be purchased. These functions are at the very heart of the entire viatical settlement transaction; accordingly, they are the type of entrepreneurial efforts which are sufficient to satisfy the fourth prong of the *Howey* test.

Further, there is a critical element vital to the success of a viatical investment and which must occur after the viatical agreement is consummated. This element is the necessity of payment of premiums on the viaticated policy. If this task is not performed, the policy will lapse and the entire investment will collapse. Very rarely is it left to the

investor to ensure that the premiums are paid. Rather, it is the promotor's responsibility (or the escrow agent picked by the promoter) to ensure these payments are made.

In *Howey*, the Supreme Court stated that the definition of a security adopted by it in that case "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." 328 U.S. at 299. The Secretary is of the view that a more flexible approach is consistent with the remedial purpose of the Act, which should be interpreted broadly to afford the maximum possible protection to Mississippi investors. Moreover, the position adopted today is consistent with that of other jurisdictions. *See, e.g.*, "Division Announces its Position on Viatical Settlements," Ohio Sec. Bull. 98:3 (Ohio Div. of Sect.); *Viatical Settlement Agreements*, No. 0-01997, 1997 Wa. Sec. Lexis 21 (Wash. Sec. Div., July 14, 1997); *Viatical Settlements*, 1996 Wy. No-Act. Lexis 3 (Wy. Sec. Div. April 26, 1996); Interpretative Opinion, 1995 Kan. Sec. No-Act. Lexis 188 (Kan. Sec. Comm'r, Nov. 14, 1995); *Viatical Settlement Contracts*, 1999 Policy Statement (Ala. Sec. Commn.); *Viatical Settlement Contracts*, 1999 Policy Statement (Alaska Div. of Bankg., Sec., & Corps.); N.D. Cent. Code § 10-04-02 (1999); Iowa Code §§ 502.102 & 502.202 (1999); Me. Rev. Stat. Ann. tit. 32, §§10501-10504, 10607-A (1999); 14 VAC § 5-71-10 et seq. (1999).

For the foregoing reasons, the Secretary of State is of the opinion that investments in viatical settlement agreements as described in this statement are investment contracts and, therefore, constitute securities within the meaning of Miss. Code Ann. § 75-71-105(l) (Rev. 1991). A number of consequences flow directly from this conclusion. The Act requires that every security offered and sold in this state must be registered with the

Secretary of State unless the security itself is exempt or unless the transaction pursuant to which the security is sold is exempt. Miss. Code Ann. § 75-71-401 (Rev. 1991). If the security or transaction is exempt from registration under Miss. Code Ann. §§ 75-71-201-203 (Rev.1991), the issuer should determine if the exemption is self-executing or if it requires a letter requesting the availability of the exemption. If no exemption is available and registration is therefore required, the issuer should review the provisions of the Act and the Rules promulgated thereunder to determine the appropriate form of registration filing and to review other substantive and procedural requirements.

Persons engaged in the business of effecting transactions in securities must be registered with the Secretary of State as broker-dealers, and individuals who represent dealers must be registered as agents, unless they qualify for an exemption from registration. Persons engaged in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issue or promulgate analyses or reports concerning securities must be registered with the Secretary of State as investment advisers. Additionally, certain individuals employed by or associated with an investment adviser must be registered as investment adviser representatives, unless they qualify for an exemption from registration.

Finally, all persons involved in the offer and sale of viatical settlements in Mississippi should be aware of the nature and extent of the antifraud provisions of the Act. Miss. Code Ann. §75-71-501 (Rev. 1991) provides that in the sale of any security in Mississippi, it is unlawful to employ any device, scheme or artifice to defraud; to make

any untrue statement of a material fact or to omit to state a material fact necessary in order to render the statements made, in light of the circumstances under which they are made, not misleading; or to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person. The antifraud provisions of the Act apply in the case of every sale of a security in Mississippi, including those instances in which the sale of the security is exempt from registration and the seller is exempt from licensing. Violation of the antifraud provisions of the Act can result in criminal prosecution of the offender.

Viatical settlements are investments, subject to regulation by the Secretary of State, as defined in the Act. They involve risks that investors may not realize exist and that unscrupulous promoters may misrepresent or fail to disclose to investors. The Secretary of State has concluded that viatical settlements are securities and that it is appropriate for the Securities Division to assert its regulatory jurisdiction. The Secretary arrived at his conclusions based on legal analysis and the long-standing public policy of investor protection. The Office of the Mississippi Secretary of State has no position and makes no representations on the social value of viatical settlements.

Dated this the 2nd day of December, 1999.

A handwritten signature in cursive script, reading "Eric Clark", written in black ink. The signature is fluid and stylized, with a long horizontal stroke extending to the right.

Eric Clark
Mississippi Secretary of State